California public employee pensions

It's going to get worse

The pension gamble

Reasons to support defined benefit plans:

- Provide predictable income
- Excellent way of risk-pooling

The pension gamble

But they require:

- Affordable benefit levels
- Realistic accounting

The pension gamble

Otherwise, they’re
risky gambles
that can load large debt
onto future generations …

The pension gamble

… draining public money that should go for delivery of needed services.

Why the public is upset

Sonny Khoo

Contra Costa

Hazardous waste materials team

Age: 50

Years on the job: 22 1/2

Final salary: $94,255

Starting pension: $126,688

Phil Kamlarz

Berkeley city manager

Age: 64

Years on the job: 36.7

Final salary: $250,000

Starting pension: $266,000

Craig Bowen

San Ramon Valley FD chief

Age: 51

Years on the job: 29

Final salary: $221,000

Starting pension: $284,000

Average pension

CalPERS likes to use an average benefit for all retirees in the system of

<u>$29,000 a year</u>

Source: CalPERS "Facts at a Glance,"
http://www.calpers.ca.gov/eip-docs/about/facts/facts-at-a-glance.pdf*, as of 6/30/12 for all retirees*

Average pension

Why is CalPERS' number so low?

- **Time period:** It includes those who retired before benefit level increases began in 2000.
- **Years worked:** It combines those who worked five years with those who put in more than 30 years. The average is 20.2

(In contrast, Social Security, for example, calculates benefits based on a working career of 35 years.)

Career-worker starting pensions

- CalPERS = $62,000/year

(FY 2010-11, 30+ years of service)

Source: CalPERS CAFR, Page 165

- CCCERA= $82,000/year

(2010, 30+ years of service)

Source: Segal memo, Aug. 11, 2011

- ACERA = $81,600/year

(2011, 30+ years of service)

Source: ACERA CAFR 2011, Page 114

Career-worker starting pensions

The majority, but not all, also receive Social Security

Adds *roughly* an average $19,000 annually for career workers

Failure to properly fund

Statewide pension shortfall was roughly $250 billion in 2011

*Unfunded liability on an MVA basis using 7.1 percent assumed rate of return. *Sources: Joe Nation, "Pension Math: How California's Retirement Spending is Squeezing the State Budget," Dec. 13, 2011; Evan Storms and Joe Nation, "More Pension Math: Funded Status, Benefits and Spending Trends for California's Largest Independent Public Employee Pension Systems," Feb. 21, 2012.*

Failure to properly fund

$250 billion …

… averages $20,000 per California household.

… more than double annual state and local government payroll.

2013 Pension “reform”

PEPRA was a tweak

2013 Pension “reform”

Of the $250 billion UL,

CalPERS’ share was about $100 billion.

2013 Pension "reform"

Let's give it scale:

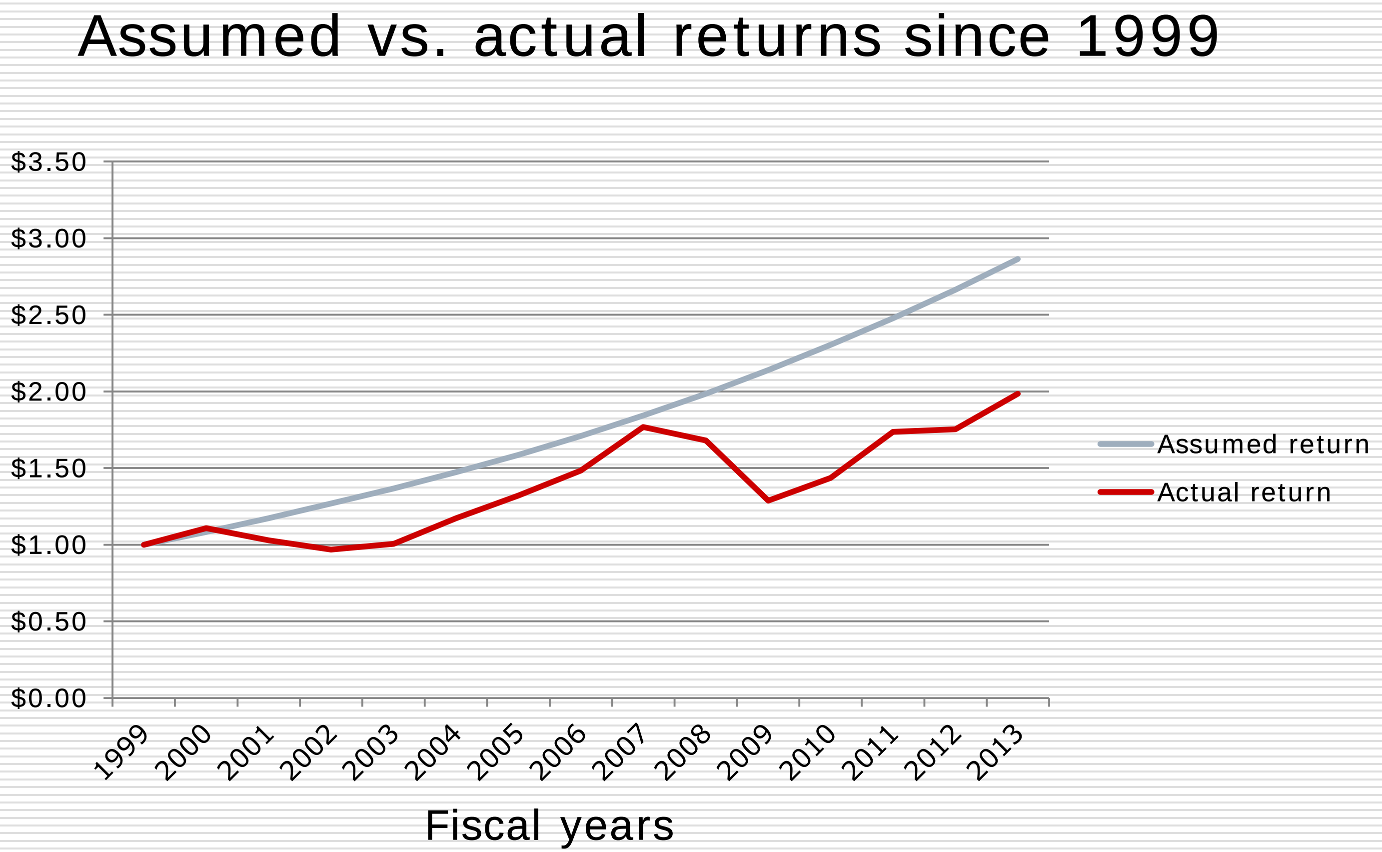
- Shortfall: **<u>About $100 billion</u>**.
- CalPERS estimated present value of savings from PEPRA over 30 years: **<u>$12 billion - $15 billion</u>**.

Sources: "CalPERS Facts at a Glance," August 2012; "CalPERS Actuarial Cost Analysis of California Public Employees' Pension Reform Act of 2013,"Aug. 31, 2012.

2013 Pension “reform”

Meanwhile, the numbers have gotten worse at CalPERS as it corrects for past sins

CalPERS – investment returns



CalPERS – 2012 (pre-PEPRA)

Lowered assumed investment return from 7.75% to 7.5%

(Actuary had recommended 7.25%)

CalPERS – 2012 (pre-PEPRA)

That meant higher rates

CalPERS - 2013

"We're concerned about ... very slow progress towards full funding."

-- CalPERS Chief Actuary Alan Milligan, March 19, 2013

CalPERS - 2013

Next downturn: "Significant risk of large contribution rate increases in a single year."

CalPERS - 2013

Milligan accounting changes include:

- Ended asset smoothing.
- Amortize unfunded liability over 25 years.
- Do the rate calculations and then smooth them in over five years.

CalPERS - 2013

Upshot:

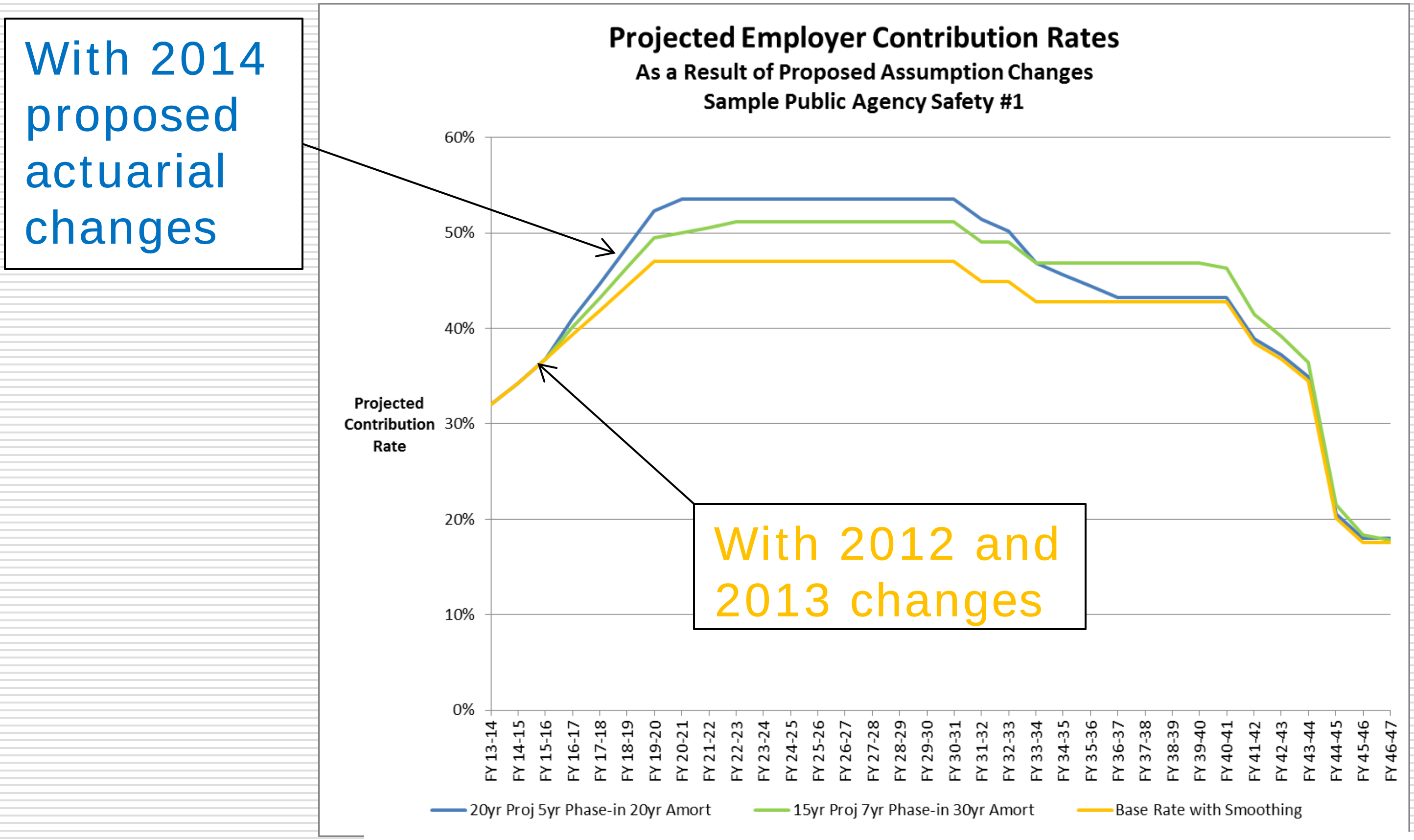
The system needs more money now. So, employer rates will go up even more starting in FY 2015-16 for local agencies.

CalPERS - 2014

Actuarial changes:

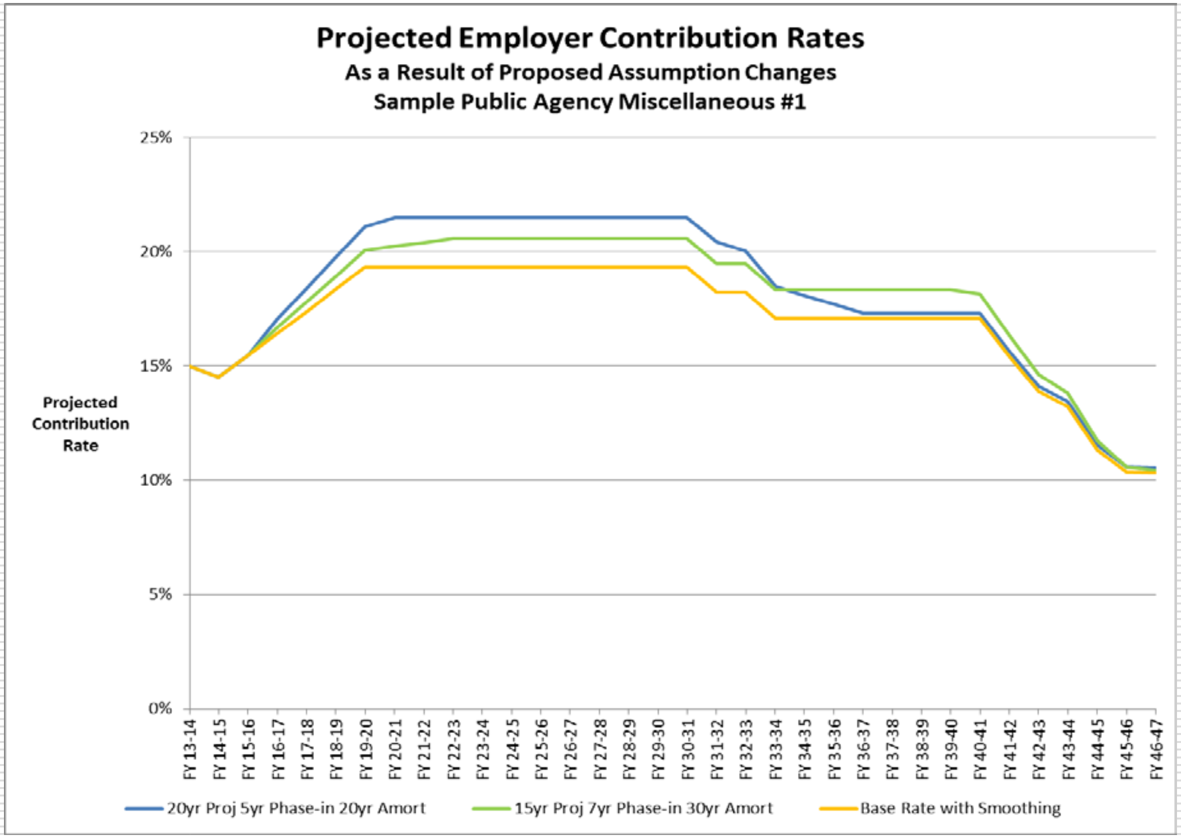
- Life expectancy will continue to increase
- CHP would rather play golf than work for about the same amount of money

Future ER rates: Local safety



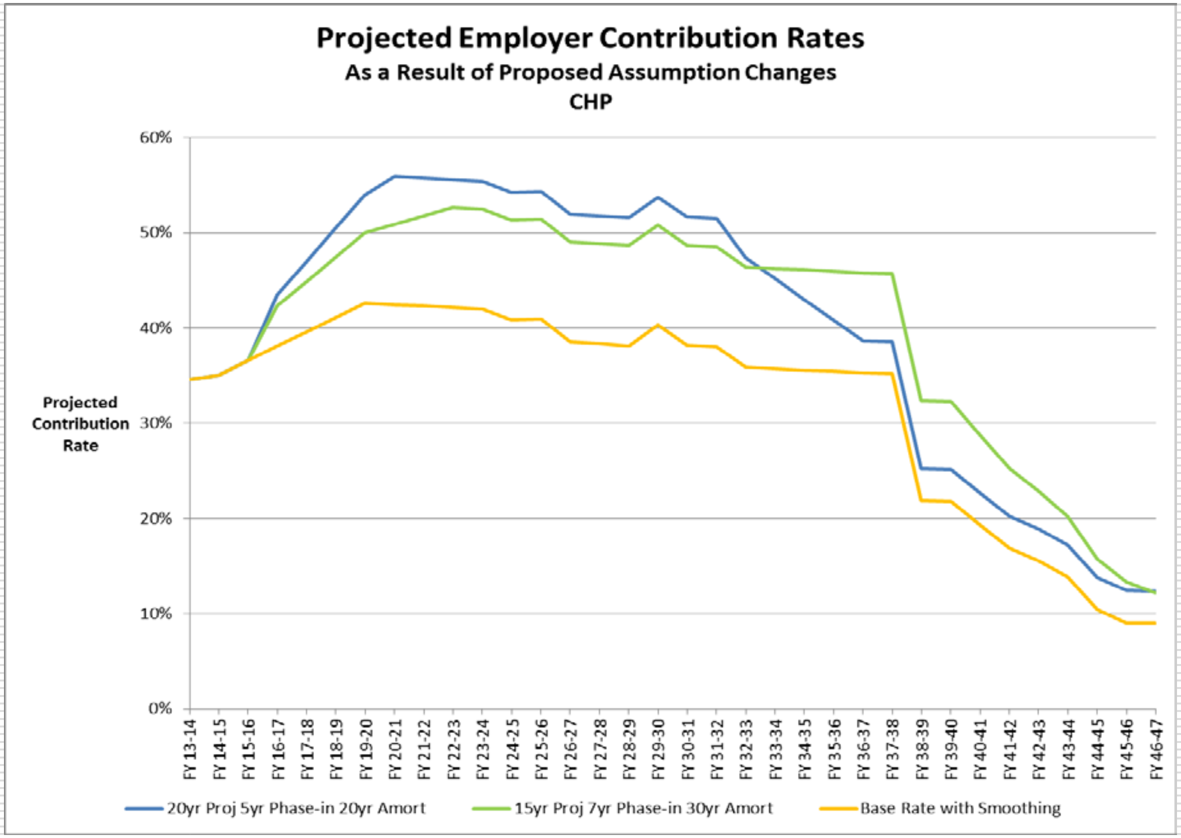
Source: CalPERS slide from legislative briefing, Dec. 4, 2013

Future ER rates: Local misc.



Source: CalPERS slide from legislative briefing, Dec. 4, 2013

Future ER rates: CHP



Source: CalPERS slide from legislative briefing, Dec. 4, 2013

Non-CalPERS East Bay effect

<u>Recent service cuts</u>

CCCFPD: 67 cents / $1 of payroll

MOFD: 67 cents / $1 of payroll

<u>Recent consumer rate increases</u>

Central San: >60 cents / $1 of payroll

EBMUD: 38 cents / $1 of payroll

(Pension rates are ER share only; does not include EE contribution.)

Contribution rates

Two key components of rates

- Normal cost
- Unfunded liability

Normal cost

Public employee pensions are supposed to be <u>pre-funded</u>

Normal cost

So actuaries calculate …

… how much should be invested now

… to provide in the future for the pensions <u>that are currently being earned</u>

Normal cost

The normal cost is part of the price for current labor, just like salary, health care insurance, disability insurance, etc.

Normal cost

The normal cost has nothing to do with past investment losses

Unfunded liability

When the normal cost assumptions fall short, we're left with an unfunded liability.

It's a debt.

Unfunded liability

Public pension systems amortize the unfunded liability:

- 18 years (CCCERA)
- 22 years (ACERA)
- 30 years (CalPERS, CalSTRS)

Unfunded liability

We're pushing the debt into the future, making future generations pay for it

Unfunded liability

- We’ve already consumed the labor
- Future generations will not benefit from it.
- These are not capital projects.

Unfunded liability

It’s like charging last night’s steak dinner on your home mortgage

The total cost

Estimate of 2015-16 CalPERS typical costs for local public safety

28 cents (normal cost)*

+ 17 cents (unfunded liability)

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45 cents (current total cost)

* Includes 9-cent employee share.

Source: Actuary John Bartel

The total cost

"State and local governments have made a promise to workers they can no longer afford."

-- Bipartisan Little Hoover Commission

(Source: "Public Pensions for Retirement Security," February 2011)

Change

We're stuck with the unfunded liability

Change

The main way to change the normal cost is the lower the <u>future</u> rate of accrual. That’s where vested rights come in.

Note: No one proposes altering pension benefits that have already been earned.

Change

"The problem ... cannot be solved without addressing the pension liabilities of current employees. The state and local governments need the authority to restructure <u>future, unearned retirement benefits</u> for their employees."

(Source: "Public Pensions for Retirement Security," Little Hoover Commission, February 2011)